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Supreme Court, U.S.
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No. 07-963

IN THE

Supreme Court of the United States

EXCEL INNNOVATIONS, INC. and NED HOFFMAN,

Petitioners,

v.

INDIVOS CORPORATION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether, in granting an injunction pursuant to 11 U.S.C. § 105(a), the bankruptcy courts may apply a test that measures the impact of the matter enjoined on the administration of the bankruptcy case, or whether they are required to apply the traditional federal court standards for granting a preliminary injunction.

2. Whether, assuming *arguendo* that the traditional preliminary injunction standards apply in the situation described above, the likelihood of success on the merits criterion may be satisfied once it is shown that the matter enjoined will have a potentially adverse impact on the administration of the bankruptcy case.

PARTIES AND RULE 29.6 DISCLOSURE

The petitioners are Excel Innovations, Inc., a California Corporation, and Ned Hoffman, who were appellees below. The respondent Indivos Corporation was one of the appellants below. Solidus Systems, Inc. ("Solidus"), the remaining appellant below, is a debtor in a bankruptcy case pending in the United States Bankruptcy Court for the Central District of California (Case No. 1:07-20027-TD). The automatic stay of 11 U.S.C. § 362(a) prevents petitioners from continuing this proceeding as against Solidus, and petitioners will advise the Court when and if the automatic stay lifts, terminates or expires as to Solidus. Excel Innovations, Inc. has no parent corporation; nor does any publicly held corporation hold 10% or more of the corporation's stock.

TABLE OF CONTENTS

	Page
Questions Presented	i
Parties and Rule 29.6 Disclosure	ii
Table of Contents	iii
Table of Appendices	v
Table of Cited Authorities	vi
Opinions and Orders Below	1
Jurisdiction	1
Statutory Provision Involved	1
Statement of the Case	2
Reasons for Granting the Petition	7
I. This Court should resolve the conflict among the circuits on the important question as to what are the appropriate criteria to be followed by the bankruptcy courts in granting injunctions under 11 U.S.C. § 105(a) against proceedings in other courts that threaten to interfere with the administration of a bankruptcy case.	7

Contents

Page

II. Even if the Ninth Circuit adopted the correct rule regarding the standards for injunctive relief under §105(a), this Court should resolve the conflict that exists among the circuits as to the proper application of the traditional standards. .. 13

Conclusion 18

TABLE OF APPENDICES

Page

Appendix A — Opinion Of The United States Court Of Appeals For The Ninth Circuit Filed September 7, 2007 ..... 1a

Appendix B — Order For Preliminary Injunction Of Limited Duration Of The United States Bankruptcy Court For The Northern District Of California Dated December 9, 2005 ..... 28a

Appendix C — Excerpts Of Hearing On Plaintiff's Supplemental Application For Tro And Preliminary Injunction Dated December 2, 2005 ..... 31a

Appendix D — Order Of The United States Court Of Appeals For The Ninth Circuit Denying Petition For Rehearing En Banc Filed October 23, 2007 ..... 41a

TABLE OF CITED AUTHORITIES

Page

Cases

A.H. Robins Co., Inc. v. Piccinin,
788 F.2d 994 (4th Cir. 1986) ..... *passim*

Federal Trade Commission v. Standard Oil Company of California,
449 U.S. 232 (1980) 8

Fisher v. Apostolou,
155 F.3d 876 (7th Cir. 1998) 10

In re Adelphia Communications Corp.,
298 B.R. 49 (S.D.N.Y. 2003) 10

In re Baldwin-United Corp. Litigation,
765 F.2d 343 (2nd Cir. 1985) 7

In re Barnett,
435 F.3d 971 (9th Cir. 2006) 5

In re Commonwealth Oil Ref. Co.,
805 F.2d 1175 (5th Cir. 1986) 10, 15

In re DeLorean Motor Co.,
991 F.2d 1236 (6th Cir. 1993) 7, 12, 16

In re Eagle Pitcher Industries, Inc.,
963 F.2d 855 (6th Cir. 1992) 11, 15, 16

Cited Authorities

Page

In re G.S.F. Corp.,
938 F.2d 1467 (1st Cir. 1999) 16

In re Hunt,
93 B.R. 484 (Bkrtcy. N.D. Tex. 1988) 8, 16

In re Joelson,
427 F.3d 700 (10th Cir. 2005) 5

In re L & S Industries, Inc.,
989 F.2d 929 (7th Cir. 1993) 10

In re Mirant Corp,
299 B.R. 152 (Bkrtcy. N.D. Tex. 2003) 16

In re Wedgewood Realty Group, Ltd.,
878 F.2d 693 (3rd Cir. 1989) 11

Kreisler v. Goldberg,
478 F.3d 209 (4th Cir. 2007) 7

MacArthur Co. v. Johns-Manville Corp.,
837 F.2d 89 (2nd Cir. 1988) 10

Monarch Life Ins. Co. v. Ropes & Gray,
65 F.3d 973 (1st Cir. 1995) 9

N.L.R.B. v. Superior Forwarding, Inc.,
762 F.2d 695 (8th Cir. 1985) 8, 12, 14

Sunshine Development Inc. v. F.D.I.C.,
33 F.3d 106 (1st Cir. 1994) 7

Cited Authorities

Page

Statutes

11 U.S.C. § 105 ..... *passim*

11 U.S.C. § 105(a) ..... *passim*

11 U.S.C. § 362(a) ..... ii, 11

11 U.S.C. § 1123(b)(4) 17

28 U.S.C. § 1254(1) 1

28 U.S.C. § 1334(a) 2

28 U.S.C. § 1334(b) 2

Other Authorities

LoPucki, Lyn, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts* (Univ. of Mich. Press. 2006) 13

OPINIONS AND ORDERS BELOW

The opinion of the Court of Appeals for the Ninth Circuit is reported at 502 F.3d 1086, 2007 U.S. App. LEXIS 21459; Bankr. L. Rep. (CCH) P81,020; 48 Bankr. Ct. Dec. 212. The opinion and orders of the Ninth Circuit and the opinion and order of the United States Bankruptcy Court for the Northern District of California (unreported) are reprinted in the Appendix at pages 1a through 42a.

JURISDICTION

The Ninth Circuit filed its decision and entered its judgment on September 7, 2007. It entered an order denying petitioner's timely petition for rehearing en banc on October 23, 2007 (App. 41a). This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISION INVOLVED

11 U.S.C. § 105(a)

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

STATEMENT OF THE CASE

Petitioner Excel Innovations, Inc., ("Excel") is a debtor in possession in a chapter 11 bankruptcy case pending before the United States Bankruptcy Court for the Northern District of California. Petitioner Ned Hoffman ("Mr. Hoffman") was at one time the chief executive officer and a director of Excel. The bankruptcy court had jurisdiction over the case and the proceeding from which this appeal arose pursuant to 28 U.S.C. §§ 1334(a) and (b).

Prior to the commencement of Excel's bankruptcy case, Excel and Mr. Hoffman were co-defendants in an arbitration proceeding in which Solidus Networks, Inc. and Indivos Corporation ("Respondents") were plaintiffs. In accordance with its contractual and statutory indemnification obligation to Mr. Hoffman, Excel provided for Mr. Hoffman's defense; and Excel's counsel represented both Excel and Mr. Hoffman. The two defendants presented a common and unified defense to the claims asserted in the arbitration. As of the date that Excel filed bankruptcy the arbitration had been actively litigated over several months, but is was not yet completed. An additional forty hours of testimony had been scheduled. Excel's bankruptcy, however, stayed the arbitration.

Respondents then filed a proof of claim in Excel's bankruptcy case, asserting the same claims that had been asserted in the arbitration. Several months into the bankruptcy case Respondents also requested that Excel stipulate to relief from the bankruptcy stay in order to resume the arbitration, but Excel declined to do so

because it then lacked the resources to defend peripheral litigation and preferred to have the Respondents' claims determined in due course by the bankruptcy court. Respondents then indicated to the bankruptcy court that they might resume the arbitration against Mr. Hoffman only. The bankruptcy judge urged Respondents to proceed with caution, because to do so might violate the bankruptcy stay if it could have an adverse effect on the administration of the bankruptcy case.

Without seeking relief from Excel's bankruptcy stay, Respondents did reactivate the arbitration as against Mr. Hoffman only, over his objection that to do so would violate Excel's bankruptcy stay. In response to Mr. Hoffman's objection, Respondents obtained a ruling from the arbitrator that resuming the arbitration against Mr. Hoffman would not violate Excel's bankruptcy stay. After some confusion regarding whether or not further testimony would be taken in the arbitration, the arbitrator scheduled five days of further arbitration hearings, as previously agreed prior to Excel's bankruptcy filing.

Once the arbitrator determined he would proceed with the arbitration against Mr. Hoffman, Excel filed an adversary proceeding in the bankruptcy court asking the bankruptcy court to enjoin the arbitration against Mr. Hoffman. Although the adversary complaint alleged that the resumption of the arbitration would violate the automatic stay, what Excel was in essence alleging was that the arbitration would interfere with the administration of its bankruptcy case and have an adverse impact on its as a debtor in a reorganization case, and that was how the bankruptcy judge addressed the proceeding.

The bankruptcy court initially denied Excel's application for a temporary restraining order when Respondents offered a series of stipulations regarding conduct of the arbitration which satisfied the court there was little or no risk of harm to Excel. However, on reconsideration, it developed that Respondents could not perform on all the stipulations, so the court granted a temporary restraining order and set the matter for full briefing and argument on a motion for preliminary injunction.

In the papers and at the hearings on the motion, the focus was on whether or not the arbitration against Mr. Hoffman could cause harm to Excel. It is of significance that, although the parties referred to the traditional four-part test for granting an injunction, no party argued that the first element – likelihood of success on the merits – was to be determined by whether or not it was reasonably probable that Excel would be able to confirm a plan of reorganization. Rather all parties appeared to agree that the first element would be satisfied if Excel could prove the required level of likely or potential harm from proceeding with the arbitration against Mr. Hoffman. In other words, by showing the requisite degree of harm, Excel would *a foritiari* demonstrate likely success on the merits *of its adversary proceeding.*

The bankruptcy court granted the motion for preliminary injunction enjoining the arbitration against Mr. Hoffman. In its findings and conclusions the court determined that the test for granting the injunction under § 105(a) was whether "allowing the action to proceed [] could conceivably have any effect on the administration of the bankruptcy estate." (App. 34a and 34b). The court found that that standard was met (App. 34b).

The court went on to state that "outside the context of Section 105 in the Ninth Circuit to obtain a preliminary injunction, the moving party must show either a combination of probable success on the merits and the possibility of irreparable injury or, two, if serious questions are raised and the balance tips sharply in its favor" (App. 36a). The court then found that, "using the rationale of the Ninth Circuit . . . a consideration of the relative hardships between Indivos, Solidus, and the debtor favors an injunction for this limited period of time" (App. 37a). The court never specifically again mentioned the issue of likelihood of success on the merits, but by implication either found that Excel had shown probable success or had raised serious questions based on its demonstration of likely harm to the estate. As suggested in the briefing of the parties, the court had conflated likelihood of success and the likelihood of harm to the debtor accompanied by a lack of serious harm (merely delay) to the Respondents.

This appeal ensued.[1] The Ninth Circuit reversed the bankruptcy court. It recognized that the appropriate standard for granting an injunction under 11 U.S.C. § 105(a) was both a question of first impression in the circuit (App. 11a) and that the circuits were split on the issue (App. 13a and 14a). The Ninth Circuit chose to join

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1. As required Respondents first appealed to the Bankruptcy Appellate Panel for the Ninth Circuit. That court affirmed the bankruptcy court's order. Respondents then appealed to the Ninth Circuit. Upon such an appeal, the Court of Appeals independently reviews the bankruptcy court's decision and not the decision of the Bankruptcy Appellate panel. *In re Barnett*, 435 F.3d 971, 975 (9th Cir. 2006); *In re Joelson*, 427 F.3d. 700, 704 (10th Cir. 2005).

the Fifth Circuit in holding that the traditional preliminary injunction criteria should have been followed by the bankruptcy court, rather than the "any conceivable effect" standard of the First, Second and Seventh circuits, which the bankruptcy court had applied in this case.

The Ninth Circuit also determined that in applying the traditional criteria, the likelihood of success on the merits prong should be determined by whether there was a reasonable probability of successful reorganization by the debtor seeking the injunction. Even among courts applying the traditional preliminary injunction standards, there is a conflict within the circuits on how to apply this prong, although the Ninth Circuit did not appear to be aware of that.

Finally, the court concluded that the bankruptcy court's assessment whether the arbitration proceeding against Hoffman would have a conceivable effect on the administration of the bankruptcy case was not sufficient to meet the irreparable harm prong, particularly in view of the weak evidence (per the Ninth Circuit) on the likelihood of a successful reorganization. Accordingly, the court reversed and remanded the case to the bankruptcy court for further proceedings.

REASONS FOR GRANTING THE PETITION

I.

This Court should resolve the conflict among the circuits on the important question as to what are the appropriate criteria to be followed by the bankruptcy courts in granting injunctions under 11 U.S.C. § 105(a) against proceedings in other courts that threaten to interfere with the administration of a bankruptcy case.

Title 11 United States Code § 105(a) provides the bankruptcy courts with the power to " issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. . . ." The courts have given a broad scope to § 105(a) as granting authority to bankruptcy courts "to assure the orderly conduct of reorganization proceedings," *In re Baldwin-United Corp. Litigation*, 765 F.2d 343, 348 (2nd Cir. 1985), including the power "to enjoin parties other than the bankrupt from commencing or continuing litigation." *Kreisler v. Goldberg*, 478 F.3d 209, 215 (4th Cir. 2007). *See also Sunshine Development Inc. v. F.D.I.C.*, 33 F.3d 106, 114 (1st Cir. 1994) ["11 U.S.C. § 105 is designed to permit the court to protect (its) jurisdictional grant."]; *In re DeLorean Motor Co.*, 991 F.2d 1236, 1242 (6th Cir. 1993) ["'The basic purpose of (section 105) is to enable the court to do whatever is necessary to aid its jurisdiction. . . .'"]. Thus, it can be seen that § 105 plays an important role in the administration of bankruptcy cases.

Despite this wide agreement as to the scope and purpose of § 105, the Courts of Appeals are divided as to

what standards or criteria the bankruptcy courts should utilize in granting injunctions under its authority. This divergence of opinion undoubtedly arises because of the nature of bankruptcy cases. Bankruptcy cases are not two-party litigation but are umbrellas under which reorganization, liquidation and distribution of assets, and resolutions of disputes take place. Hence the injunctive authority of § 105 is not necessarily limited to protecting one party from irreparable harm by another, but rather to protect the integrity of the entire, extended bankruptcy proceeding and the estate's assets. For example, most courts do not consider that because a party has to expend money to oppose some action by another party that alone creates irreparable to justify injunctive relief. *E.g., Federal Trade Commission v. Standard Oil Company of California*, 449 U.S. 232 (1980). Nevertheless, in the bankruptcy context the needless or premature expenditure of the debtor's or the estate's funds may have a very serious impact on the debtor's ability to reorganize or on the amount of assets available for distribution to creditors. *See N.L.R.B. v. Superior Forwarding, Inc.*, 762 F.2d 695, 698 (8th Cir. 1985) ["(Whether) litigation expenses are a threat to the assets of a bankruptcy estate . . . is a factual determination which will have to be made by the bankruptcy courts on a case by case basis."]; *In re Hunt*, 93 B.R. 484, 496 (Bkrtcy. N.D. Tex. 1988) ["(L)itigation costs must nevertheless be considered as an element of harm to the debtors' estates. . . ."]. In sum, different considerations often inform the decision whether to grant an injunction in a bankruptcy case as compared to those relevant in traditional two-party litigation.

In its opinion the Ninth Circuit recognized that its decision was contrary to the rule applicable in the Seventh Circuit, and most likely also the First Circuit[2] (App. 14a). In fact, among the nine circuit courts that have addressed the issue in published opinions, there is a rather wide divergence of opinion as to the proper standards. The decisions essentially divide into three groups.

First, there are the circuits which have clearly adopted the position of the bankruptcy court in this case; namely that the traditional preliminary injunction standards do not necessarily apply, but rather the bankruptcy court may enjoin actions that threaten to impact the administration of the bankruptcy case. The following circuits are in this group:

First: *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 979 (1st Cir. 1995)

> We have held that Bankruptcy Code § 105(a) confers ample power upon the bankruptcy court to enjoin the initiation or continuation of judicial proceedings in a nonbankruptcy forum against nondebtors . . . where the court reasonably concludes that such actions would entail or threaten adverse "impact" on the administration of the chapter 11 estate.

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2. The court also implied that it was following the majority of circuits (App.13a). As will be seen, the court was mistaken in that regard.

Second: *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89, 93 (2nd Cir. 1988); ["(S)ection 105(a) of the Bankruptcy Code ... has been construed liberally to enjoin suits that might impede the reorganization process."] *In re Adelphia Communications Corp.*, 298 B.R. 49, 54 (S.D.N.Y. 2003) [Courts of this circuit have "embraced the use of § 105 without proof of all four factors normally required for injunctions. . . ."]

Seventh: *Fisher v. Apostolou*, 155 F.3d 876, 882; ["(T)he bankruptcy court ... found all four of the traditional elements required to support a preliminary injunction. . . .This was an unnecessary exercise, however, since 'since a bankruptcy court can enjoin proceedings in other courts when it is satisfied that such proceedings would defeat or impair its jurisdiction over the case before it.'"]; following *In re L & S Industries., Inc.*, 989 F.2d 929, 932 (7th Cir. 1993),

Second, there are now two circuits that have held that in order to grant an injunction under the circumstances present here, a bankruptcy court must find that the four traditional preliminary injunction criteria have been met. These circuits are:

Fifth: *In re Commonwealth Oil Ref. Co.*, 805 F.2d 1175, 1188-89 (5th Cir 1986).

Ninth: *In re Excel Innovations, Inc.*, 502 F.3d 1086, *supra.*

Third and finally, there are several circuits where the rule is unclear or ambiguous, although one can legitimately argue that they have rejected rigid

adherence to the traditional standards and believe that the bankruptcy courts should have greater flexibility than those standards allow. These circuits include the following:

Third: *In re Wedgewood Realty Group, Ltd.*, 878 F.2d 693, 700-701 (3rd Cir. 1989) The court reversed an order of the bankruptcy court extending the automatic stay of 11 U.S.C. § 362(a), which had expired by operation of law. In dicta, the Third Circuit concluded that the bankruptcy court could have achieved the same result by granting an injunction pursuant to § 105(a). The court did not express an opinion as to what standard should be applied.

Fourth: *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1008 (4th Cir. 1986). The Court of Appeals affirmed the granting of an injunction against a suit between non-debtor parties because the debtor demonstrated that the third-party suit, if successful, would "affect the property of the debtor to the detriment of the debtor's creditors as a whole. . . ." The court essentially conflated the likelihood of success and irreparable harm criteria into one; *i.e.*, likelihood of success was "indisputable" upon a showing of harm to the bankruptcy estate. *Id.*[3]

Sixth: *In re Eagle Pitcher Industries, Inc.*, 963 F.2d 855, 859-60 (6th Cir. 1992). The court did little more than

3. Earlier in its opinion, the Fourth circuit approvingly cited language in decisions of other circuits to the effect that § 105(a) authorizes the court to enjoin third party proceedings "which might interfere in the rehabilitative process" or "which will have an adverse impact on the Debtor's ability to formulate a plan." 788 F.2d at 1003.

pay lip service to the traditional standards As the court said, 963 F.2d at 859:

> It is important to recognize that the four considerations applicable to preliminary injunctions are factors to be balanced and *not prerequisites that must be satisfied.* These factors guide the discretion of the court, they are not meant to be rigid and unbending requirements.

(Emphasis added.) But *cf, In re DeLorean Motor Co.*, 991 F.2d at 1242, *supra* ["'Section 105(a) contemplates injunctive relief in precisely those instances where parties are "pursuing actions pending in other courts that threaten the integrity of a bankrupt's estate."'"]

Eighth: *NLRB v. Superior Forwarding, Inc.*, 762 F.2d 695, 698 (8th Cir. 1985). The court affirmed an order under § 105(a) enjoining NLRB proceedings against the debtor based on findings by the bankruptcy court "that the time and effort of management, as well as the expense required . . . threatened the assets of the estate." *Id.* at 699. In footnote three the court noted that the bankruptcy court applied the traditional preliminary injunction standards, but there was no discussion in the case which of those criteria, other than the threat of harm to the assets of the estate, were satisfied. As in *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, *supra*, the court appears to have conflated the four criteria into basically one.

As can be seen, by virtue of the fact that the issue has arisen and been addressed by nine of the circuits, it is an issue of considerable importance to the administration of the bankruptcy laws. Furthermore, the Bankruptcy Code is a federal law of national application, and it should applied and enforced uniformly in all of the federal circuits.[4] It has been persuasively argued that the differences in interpretation of the Bankruptcy Code among the circuits has led to unhealthy forum shopping. LoPucki, Lyn, *Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts* (Univ. of Mich. Press. 2006). Therefore, it is critical that this Court clarify the law and resolve the split among the circuits on this important question arising under the Bankruptcy Code.

II.

Even if the Ninth Circuit adopted the correct rule regarding the standards for injunctive relief under §105(a), this Court should resolve the conflict that exists among the circuits as to the proper application of the traditional standards.

The Ninth Circuit not only concluded that the traditional standards for granting preliminary injunctions in federal district courts apply to the granting of injunctive relief under § 105(a) of the Bankruptcy Code, but it also held that the likelihood of success on the merits prong required a showing that the

4. Indeed the Constitution provides that Congress shall have the power to "establish ... uniform Laws on the subject of Bankruptcies throughout the United States." Art. 1, Sec. 8. Hence, uniformity of the bankruptcy law is an important value.

debtor applying for the injunction has a reasonable likelihood of successful reorganization (App. 16a). This part of the Ninth Circuit's decision also places it in conflict with decisions of other Courts of Appeals.

When a debtor in a bankruptcy case applies for an injunction under § 105(a) to stay litigation in another court among non-debtor parties, its complaint will allege that the commencement or continuation of the third-party litigation will in some manner cause harm to the debtor or its estate. It will not necessarily be alleging that the third party litigation has no merit and should not go forward for that reason. For example, the debtor may alleged that the litigation will adjudicate rights of parties that should first be adjudicated in the bankruptcy court taking into account the interests of other creditors and the estate. *E.g.*, *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, 1008, *supra*. Or, the debtor may argue that the third party litigation will divert resources of the estate and time of management from the reorganization process at a critical juncture in the case *E.g.*, *NLRB v. Superior Forwarding, Inc.*, 762 F.2d 695, *supra*. In such cases, there is no underlying dispute to be litigated in the injunction proceeding, other than the question of impact of the third-party proceeding on the bankruptcy case.

For this reason courts that apply the traditional preliminary injunction standards have struggled with the question of how to measure the likelihood of success prong. This has produced a wide variety of results, among which the Ninth Circuit's solution is only one, and a rather arbitrary one at that, which is not at all meaningful in many contexts. This may be the reason why several courts have rejected the traditional criteria. But even in those courts which have either applied or alluded to the traditional

standards, their view of what constitutes likelihood of success on the merits differs from the Ninth Circuit.

The Fifth Circuit with which the Ninth Circuit is clearly in accord on the traditional standards, *In re Commonwealth Oil Ref. Co.*, 805 F.2d 1175, *supra*, did not utilize the reasonable probability of successful reorganization as its test whether the debtor demonstrated the likelihood of success on the merits. Rather, under the circumstances of that case, where the debtor was seeking to enjoin an administrative agency proceeding, the court instead affirmed the denial of injunctive relief based on the bankruptcy court's finding that the debtor was unlikely to prevail in the proceeding it wanted to enjoin. *Id.* at 1189.

The court in *A.H. Robins Co., Inc. v. Piccinin*, 788 F.2d 994, *supra*, (noting that the district court applied the test for a grant of preliminary injunction) held that the likelihood of success on the merits became "indisputable" once the debtor demonstrated that the third party proceeding, "if successful would reduce and diminish the insurance fund or pool" available to pay creditors of the debtor. *Id.* at 1008. The court did not at any time discuss whether the debtor had a reasonable probability of successfully reorganizing.

The one circuit which has referred to the likelihood of successfully reorganizing, *In re Eagle Pitcher Industries, Inc.*, 963 F.2d 855, *supra*, articulated the test in a way that in most cases would be relatively easy to satisfy. While the bankruptcy court had made no specific finding about the debtor's reorganization prospects, the Sixth Circuit concluded that it was "implicit" from the granting of the injunction that the bankruptcy court believed the debtor "had some realistic *possibility* of successfully

reorganizing." *Id.* at 860 (emphasis added). It also is important to keep in mind, as noted above, that the Sixth Circuit in *Eagle-Picher Industries*, stated that the four preliminary injunction criteria are to be applied flexibly, and are not prerequisites that must be satisfied. Indeed, the court virtually dismissed the likelihood of success prong as irrelevant. *Id.*[5]

Bankruptcy courts in the Fifth Circuit have struggled with the difficulty of applying the likelihood of success on the merits in § 105(a) injunction actions. As the court said in *In re Hunt*, 93 B.R. at 493, *supra*, "In the Bankruptcy [sic] context, the focus on the merits varies somewhat because of the many interests involved in the bankruptcy case." In *In re Mirant Corp*, 299 B.R. 152, 166 (Bkrtcy. N.D. Tex. 2003), the court identified three different possible ways of measuring likelihood of success on the merits. It concluded, however, that it did not have to decide which way was most appropriate, because the debtor could satisfy all three.

In addition to the confusion that exists among the circuits as to how likelihood of success on the merits is to be measured, the Ninth Circuit's approach is ill-advised.

For example, it would have no applicability in a chapter 7 cases, where § 105(a) injunctions have been granted. *E.g.*, *In re G.S.F. Corp*, 938 F.2d 1467 (1st Cir. 1999).

For example, it would seem irrelevant where the primary purpose of the injunction is to prevent an action

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5. Based on the Sixth Circuit's later decision in *In re DeLorean Motor Co.*, 991 F.2d 1236, *supra*, it is not clear where the Sixth Circuit stands on the standards for granting an injunction under § 105(a). (*See* p. 12, *supra*)

which may reduce assets available to the debtor's creditors as a whole. *E.g.*, *A.H. Robins Co., Inc.*, 788 F.2d 994, *supra*. This factor would be important whether the chapter 11 case will result in a successful reorganization or not.

For example, Bankruptcy Code § 1123(b)(4) (11 U.S.C. § 1123(b)(4)), contemplates a liquidating chapter 11 plan. How would the likelihood of success criterion enunciated by the Ninth Circuit be applied where an orderly liquidation plan is proposed or may result?

For example, how could a bankruptcy court effectively evaluate the debtor's likelihood of successful reorganization in the very early stages of a large and complex chapter 11 case; or in a case where the reorganization depends on the outcome of litigation in which the debtor has an interest? Under such circumstances, the court's determination regarding the debtor's reorganization prospects would be little more than speculation.

In the event the Court should adopt the Ninth Circuit's view on the applicability of the traditional preliminary injunction standards to request for injunctions under § 105(a), the Court should clarify how the bankruptcy courts are to apply those criteria, especially the likelihood of success on the merits prong. In doing so it should reject the Ninth Circuit's ill-advised approach.

CONCLUSION

For the reasons stated above, the Court should grant the petition for a writ of certiorari and reverse the decision of the United States Court of Appeals for the Ninth Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT FILED SEPTEMBER 7, 2007

UNITED STATES COURT OF APPEALS NINTH CIRCUIT

No. 06-17288.

In re EXCEL INNOVATIONS, INC.,

Debtor,

Solidus Networks, Inc.; Indivos Corporation,

Appellants,

v.

Excel Innovations, Inc.; Ned Hoffman,

Appellees.

Argued and Submitted June 11, 2007.
Filed Sept. 7, 2007.

Before: ALFRED T. GOODWIN, JAY S. BYBEE, and MILAN D. SMITH, JR., Circuit Judges.

GOODWIN, Senior Circuit Judge:

Debtor Excel Innovations, Inc. ("Excel") applied for a preliminary injunction staying arbitration proceedings between two non-bankrupt parties, Indivos Corporation

("Indivos") and former Excel CEO Ned Hoffman ("Hoffman"). The bankruptcy court granted the injunction, finding a reasonable probability that the arbitration could conceivably affect the debtor and the bankruptcy estate. The Bankruptcy Appellate Panel ("BAP") affirmed. The present appeal followed.

We hold that when a debtor applies for a 11 U.S.C. § 105(a) preliminary injunction to stay a proceeding in which the debtor is not a party, the bankruptcy court must balance the debtor's likelihood of success in reorganization against the relative hardship of the parties, as well as consider the public interest if warranted. Because the bankruptcy court misapprehended the operative legal standard, we reverse and remand for further proceedings.

I. BACKGROUND

Hoffman is the founder and a major shareholder of both Indivos and Excel. In 2000, Hoffman entered into a series of agreements ("Settlement Contracts") with Indivos. These included the Settlement Agreement and General Release, the Voting Trust and Standstill Agreement, the Pledge Agreement, and the Proprietary Information and Inventions Agreement. One of the main purposes of these agreements was to separate Hoffman from the management of Indivos. Excel, which was controlled by Hoffman and separately owned Indivos shares, was not a party to the Settlement Agreement or the Pledge Agreement. However, Excel was a party to

the Voting Trust and Standstill Agreement, which required Hoffman and Excel to place their Indivos shares in a voting trust as collateral for their obligations under the Settlement Contracts. Section 9(a) of the Voting Trust and Standstill Agreement, which applied to Hoffman only, prohibited him from "individually or with others, directly or indirectly," taking any action to "control, disrupt, or unduly influence the management or policies of [Indivos]." The parties agreed to submit any dispute arising from the Settlement Contracts to binding arbitration with the American Arbitration Association ("AAA").

In June 2003, Indivos initiated AAA arbitration proceedings against Hoffman and Excel. Indivos alleged that Hoffman and Excel attempted to disrupt a merger between Indivos and Solidus Networks, Inc. ("Solidus") by, inter alia, filing multiple shareholder derivative actions, initiating a proxy contest, and attempting to gain a seat on the Indivos board. Indivos also alleged that Excel and Hoffman filed a patent infringement action against Indivos in the Northern District of California in violation of the Proprietary Information and Inventions Agreement. Indivos claimed that it, not Excel, owned the patents at issue. Indivos pled seven claims for relief, including breach of the Settlement Contracts, unfair business practices, and breach of fiduciary duty by Hoffman. Indivos also sought to hold Excel liable as Hoffman's alter ego.

On May 14, 2004, the arbitrator granted partial summary judgment for Indivos, finding Hoffman liable

for breach of contract because he filed lawsuits to disrupt the merger, urged shareholders to vote against the merger, and tried to get on the Indivos board. The arbitrator found Excel liable as Hoffman's alter ego for some of the lawsuits Excel filed under Hoffman's direction, but denied summary judgment as to other lawsuits filed by Excel. The arbitrator further denied summary judgment with respect to merger-disrupting actions undertaken by two alleged surrogates of Hoffman. The arbitrator postponed any determination of the parties' patent rights, including whether their positions on patent ownership were taken in good faith, until resolution of the patent litigation in federal district court. The arbitrator also dismissed without prejudice Indivos' unfair business practices claim.[1] Less than a week later, the arbitrator began hearings on the remaining claims and damages.

In late May 2004, Excel and Hoffman suffered a significant setback in their patent infringement action against Indivos. Judge Chesney of the Northern District of California granted partial summary judgment for Indivos, ruling that all of the patents Excel accused Indivos of infringing were actually owned by Indivos.

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1. The alleged unfair business practice was that Hoffman attempted to disrupt the merger by arguing to Indivos shareholders that Indivos was not getting a satisfactory price for its patents, but then suing Indivos on the ground that those same patents were owned by Excel. Indivos sought to condition the release of the merger proceeds for Indivos shares held by Excel and Hoffman on their cessation of the patent litigation.

Appendix A

In June 2004, Hoffman and Excel filed bankruptcy petitions under Chapter 13 and Chapter 11, respectively. The bankruptcy filings automatically stayed the arbitration against Hoffman and Excel, as well as the patent litigation. *See* 11 U.S.C. § 362(a). At that point in the arbitration, Indivos and Solidus had concluded their affirmative case, Hoffman and Excel had presented a substantial part of their defense, and the parties were attempting to schedule additional hearing dates to finish the proceeding. Hoffman's bankruptcy petition was dismissed in September 2004. In December 2004, Hoffman resigned as an officer and director of Excel.

In February 2005, Indivos recommenced arbitration against Hoffman, on the ground that the stay established by Hoffman's bankruptcy petition had been lifted. Hoffman argued to the arbitrator that the stay established by Excel's bankruptcy petition applied to Indivos' claims against him because those claims were intertwined with Indivos' claims against Excel. The arbitrator disagreed. The arbitrator stated that any claims that alleged direct or alter ego liability for Excel remained subject to the stay, but claims involving only Hoffman could proceed. The arbitrator did not schedule further evidentiary hearings and asked Hoffman and Indivos to submit closing briefs by July 29, 2005.

In July 2005, Excel initiated adversary proceedings in bankruptcy court against Indivos, Solidus, Hoffman, AAA, and the arbitrator. Excel sought declaratory and injunctive relief on the ground that the arbitration violated the automatic stay in Excel's bankruptcy case.

According to Excel, Hoffman might argue that he acted as Excel's agent, leading to new liabilities for Excel and the bankruptcy estate. On the same day, Excel applied for a temporary restraining order ("TRO") to stop the arbitration. To reassure the court that the arbitration would not affect Excel, Indivos and Solidus stipulated that the arbitration would have no preclusive effect on Excel; that damages against Hoffman would not be offset against the Indivos shares Excel had pledged to the voting trust; and that to avoid privilege issues, no further evidence would be presented in the arbitration proceeding. The bankruptcy court denied the TRO on the basis of these representations.

Hoffman then wrote to AAA to request changes to the briefing schedule so he could present additional evidence. The arbitrator agreed. Hoffman immediately filed an ex parte application to reopen Excel's motion for a TRO and preliminary injunction. Counsel argued that, because the arbitrator now planned to take additional evidence, one of the bases for denying the injunction—Indivos' agreement not to present additional evidence—was no longer present. The bankruptcy court entered a TRO. The court expressed concern that information subject to Excel's attorney-client privilege could be revealed by Hoffman in the arbitration proceeding.

In September 2005, Excel filed a motion for a preliminary injunction. The motion was supported by an affidavit from Hoffman. He had served as Excel's CEO during the events that gave rise to Indivos' claims, but

at this time was only a consultant for Excel. In the affidavit, Hoffman offered three reasons why permitting arbitration against him would adversely impact Excel. First, he planned to demand indemnification from Excel on the ground that he was acting as an officer and agent of Excel when he challenged the Solidus-Indivos merger. Thus, arbitration could lead to new liabilities for Excel. Second, his defense would focus on his own interests and not those of Excel. Third, he would be "compelled to reveal the substance of critical privileged communications between myself and attorneys for the Debtor," because he acted "in accordance with legal advice from attorneys for the Debtor." He also intended to call Excel employees as witnesses.

The bankruptcy court granted an injunction staying arbitration until confirmation of Excel's reorganization plan. The court stated that a § 105(a) injunction is proper if arbitration "could conceivably have any effect on the administration of the bankruptcy estate." The court decided that Excel established a "reasonable probability" of possible negative impacts on the estate. Moreover, the court found that Excel's motion also satisfied the traditional, non-bankruptcy test for a preliminary injunction, which "balances the plaintiff's likelihood of success [on the merits] against the relative hardship to the parties." *See Clear Channel Outdoor Inc. v. City of Los Angeles*, 340 F.3d 810, 813 (9th Cir.2003). The bankruptcy court made no findings on plaintiff's likelihood of success, but concluded that a stay would protect Excel from possible injury while causing no harm to Indivos and Solidus.

Indivos and Solidus appealed to the BAP, contending that the bankruptcy court applied the wrong legal standard to the motion for a preliminary injunction. The BAP affirmed. The BAP noted that the Ninth Circuit has not established a standard for a § 105(a) motion to enjoin an action against a nondebtor. Citing a series of Fourth Circuit opinions, the BAP stated that a § 105(a) injunction is appropriate when the debtor and non-debtor's interests are so intertwined that an action against the non-debtor is in effect a claim against the debtor. *See, e.g., A.H. Robins Co. v. Piccinin,* 788 F.2d 994 (4th Cir.1986); *Oberg v. Aetna Cas. & Sur. Co.* (*In re A.H. Robins Co.*), 828 F.2d 1023 (4th Cir.1987). The BAP concluded that "to the extent that § 105 is recognized as authority for granting injunctive relief in matters that are related to the bankruptcy case, we hold that the bankruptcy court correctly asserted its § 105(a) authority in enjoining Appellants' arbitration proceeding." Alternatively, the BAP found that Excel had also satisfied the traditional standard for a preliminary injunction. The BAP explained that Excel had shown likelihood of success on the merits because the reorganization plan had a "fair chance" of success. The BAP further noted that permitting arbitration to proceed would cause irreparable harm to Excel. Appellants filed a timely notice of appeal.

II. JURISDICTION

Although parties do not challenge our jurisdiction over this appeal, we have an independent obligation to inquire into the presence or absence of subject matter

jurisdiction. *Moldo v. Ash* (*In re Thomas*), 428 F.3d 1266, 1268 (9th Cir.2005). Under 28 U.S.C. § 158(d), we have jurisdiction to hear appeals from "final decisions" of the BAP. We look to the underlying bankruptcy court order reviewed by the BAP to determine whether the BAP decision is final. *Lievsay v. W. Fin. Sav. Bank* (*In re Lievsay*), 118 F.3d 661, 662 (9th Cir.1997). "If the underlying bankruptcy court decision is interlocutory, the BAP order affirming or reversing it is also interlocutory." *Id.*

We hold that the injunction granted by the bankruptcy court constitutes an appealable final decision. The injunction is in effect an extension of the automatic stay, halting another proceeding to avoid disruption of the debtor's reorganization. We have held that a decision granting or denying relief from a § 362(a) automatic stay constitutes a final order for purposes of appellate jurisdiction. *Crocker Nat'l Bank v. Am. Mariner Indus., Inc.* (*In re Am. Mariner Indus., Inc.*), 734 F.2d 426, 429 (9th Cir.1984), *overruled on other grounds by United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 108 S.Ct. 626, 98 L.Ed.2d 740 (1988). We see no reason to treat the instant injunction differently. *See Gruntz v. County of Los Angeles* (*In re Gruntz*), 202 F.3d 1074, 1082 (9th Cir.2000) (en banc) ("The automatic stay is an injunction issuing from the authority of the bankruptcy court."). Moreover, although the parties and the bankruptcy court labeled the injunction "preliminary," nothing in the record indicates that the bankruptcy court contemplated

further proceedings on the injunction. *See Shugrue v. Air Line Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc.)*, 139 B.R. 772, 778 (S.D.N.Y.1992) ("[W]here the bankruptcy court issues a 'preliminary' injunction, but contemplates no further hearings on the merits of the injunction, apart from the outcome of the reorganization, the injunction is a final, appealable order.").

III. STANDARD OF REVIEW

The decision of the BAP is reviewed de novo. *Contractors' State License Bd. of Cal. v. Dunbar (In re Dunbar)*, 245 F.3d 1058, 1061 (9th Cir.2001). "On appeal from the BAP, this court independently reviews bankruptcy courts' rulings." *Id.* The injunction will be reversed only if the bankruptcy court abused its discretion by basing its decision on an incorrect legal standard or on clearly erroneous findings of fact. *See id.; see also Ragsdale v. Haller*, 780 F.2d 794, 795 (9th Cir.1986).

IV. DISCUSSION

A. *Preliminary Injunction Standard*

Under 11 U.S.C. § 105(a), a bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Section 105(a) gives the bankruptcy courts the power to stay actions that are not subject to the

11 U.S.C. § 362(a) automatic stay[2] but "threaten the integrity of a bankrupt's estate." *Canter v. Canter (In re Canter)*, 299 F.3d 1150, 1155 (9th Cir.2002) (citation and quotation marks omitted); *Ingersoll-Rand Fin. Corp. v. Miller Mining Co.*, 817 F.2d 1424, 1427 (9th Cir.1987). The proper standard for granting a § 105(a) preliminary injunction staying an action against a non-debtor is an issue of first impression in our circuit. Appellants argue that the bankruptcy court must apply the usual preliminary injunction standard. Excel disagrees, and claims that the movant need not show irreparable harm, only that the injunction would conform to the objectives of the Bankruptcy Code.

In the non-bankruptcy context, we have consistently required trial courts deciding preliminary injunction motions to balance the moving party's likelihood of success on the merits and the relative hardship of the parties. The moving party must show:

> (1) a strong likelihood of success on the merits, (2) the possibility of irreparable injury to plaintiff if preliminary relief is not granted, (3) a balance of hardships favoring the plaintiff, and (4) advancement of the public interest (in certain cases). Alternatively, a court may grant the injunction if the plaintiff

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2. The automatic stay applies to any "proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title." 11 U.S.C. § 362(a)(1).

> demonstrates *either* a combination of probable success on the merits and the possibility of irreparable injury *or* that serious questions are raised and the balance of hardships tips sharply in his favor.
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> As we have said many times regarding the two alternative formulations of the preliminary injunction test: These two formulations represent two points on a sliding scale in which the required degree of irreparable harm increases as the probability of success decreases. They are not separate tests but rather outer reaches of a single continuum.

Save Our Sonoran, Inc. v. Flowers, 408 F.3d 1113, 1120 (9th Cir.2005) (citations and internal quotation marks omitted). We have applied this usual approach in reviewing a preliminary injunction issued by a bankruptcy court to prevent the debtor's shareholder from dissipating assets claimed by the estate. *Rubin v. Pringle* (*In re Focus Media Inc.*), 387 F.3d 1077, 1085-86 (9th Cir.2004). However, in a case involving stay of a suit against a court-appointed bankruptcy trustee, we have also stated that "our usual preliminary injunction standard does not apply to injunctions issued by the bankruptcy court pursuant 11 U.S.C. § 105," and that "the court does not need to demonstrate an inadequate remedy at law or irreparable harm." *Beck v. Fort James Corp.* (*In re Crown Vantage, Inc.*), 421 F.3d 963, 975-76 (9th Cir.2005).

Appendix A

The majority of circuits that have reviewed injunctions staying actions against non-debtors have applied the usual preliminary injunction standard. *Am. Imaging Servs. v. Eagle-Picher Indus., Inc.* (*In re Eagle-Picher Indus., Inc.*), 963 F.2d 855, 858 (6th Cir.1992); *Piccinin*, 788 F.2d at 1008 (4th Cir. 1986); *Commonwealth Oil Ref. Co. v. EPA* (*In re Commonwealth Oil Ref. Co.*), 805 F.2d 1175, 1188-89 (5th Cir.1986). As the Fifth Circuit pointed out in *Commonwealth Oil*, the traditional approach is strongly supported by the legislative history of § 105(a). 805 F.2d at 1188-89. The relevant Senate report explained that § 105(a) grants bankruptcy courts "all the traditional injunctive powers of a court of equity." S.Rep. No. 95-989, at 51 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5837. "Stays or injunctions issued under these other sections will not be automatic upon the commencement of the case, but will be granted or issued under *the usual rules for the issuance of injunctions.*" *Id.* (emphasis added). The Second, Third, and Eighth Circuits have similarly applied the traditional standard with respect to stays that are not automatic under § 362(a). *See NLRB v. Superior Forwarding, Inc.*, 762 F.2d 695, 699 n. 3 (8th Cir.1985) (staying NLRB regulatory proceeding against debtor); *Wedgewood Inv. Fund v. Wedgewood Realty Group, Ltd.* (*In re Wedgewood Realty Group, Ltd.*), 878 F.2d 693, 700-01 (3d Cir.1989) (reimposing automatic stay); *Manville Corp. v. Equity Sec. Holders Comm.* (*In re Johns-Manville Corp.*), 801 F.2d 60, 68-69 (2d Cir.1986) (reversing stay of shareholder action seeking to compel debtor to hold an annual meeting).

The Seventh Circuit, in contrast, has expressly held that the moving party need not show irreparable harm. *Fisher v. Apostolou*, 155 F.3d 876, 882 (7th Cir.1998); *In re L & S Indus., Inc.*, 989 F.2d 929, 932 (7th Cir.1993).[3] The Seventh Circuit's approach rests upon the notion that "[w]hen the evidence shows that the defendants are engaged in . . . the act or practices prohibited by a statute which provides for injunctive relief to prevent such violations, irreparable harm to the plaintiffs need not be shown." *In re Chicago, Milwaukee, St. Paul and Pac. R.R.*, 738 F.2d 209, 213 (7th Cir.1984). That proposition has its roots in *United States v. City and County of San Francisco*, 310 U.S. 16, 30-31, 60 S.Ct. 749, 84 L.Ed. 1050 (1940), in which the Supreme Court affirmed an injunction against a municipality for violating the terms of a federal land grant. Ultimately, that decision turned on the Court's interpretation of congressional intent behind the land grant statute.

We hold that the usual preliminary injunction standard applies to stays of proceedings against non-debtors under § 105(a). As the relevant House and Senate reports indicate, Congress intended that standard to apply to § 105(a) preliminary injunctions. S.Rep. No. 95-989, at 51 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5836-37; H.R.Rep. No. 95-595, at 342 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6298. Moreover, we have

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3. The First Circuit has also stayed a non-debtor action without applying or discussing the usual preliminary injunction standard. *In re G.S.F. Corp.*, 938 F.2d 1467, 1474-76 (1st Cir.1991), *overruled on other grounds by Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992).

consistently held that the automatic stay does not apply to suits against non-debtors. *See Chugach Timber Corp. v. N. Stevedoring & Handling Corp.* (*In re Chugach Forest Prods., Inc.*), 23 F.3d 241, 246 (9th Cir.1994) (summarizing cases). The usual standard helps to ensure that stays would not be granted lightly.

Crown Vantage does not compel a different result. There, defendants in an adversary action filed by the debtor's trustee had sued the trustee in state court, alleging that the adversary action was barred by a prior settlement agreement between the defendants and the debtor. *See Crown Vantage*, 421 F.3d at 969. Citing the *Barton* doctrine,[4] which prohibits suits against court-appointed receivers in other fora without permission from the appointing court, the trustee successfully moved the bankruptcy court to enjoin the state court action. The district court vacated the injunction, finding that the trustee failed to show irreparable harm. *Id.* at 969-70. We reversed, stating that "[t]he only requirement for the issuance of an injunction under § 105 is that the remedy conform to the objectives of the Bankruptcy Code." *Id.* at 975. As we explained, it makes no sense to require a showing of irreparable harm in the context of *Barton*'s bright-line prohibition of unauthorized litigation against court-appointed receivers. Once such an action had been filed, "[t]he only appropriate remedy . . . is to order cessation of the improper action." *Id.* at 976. In other words, irreparable harm need not be shown because the movant was certain to succeed on its claim

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4. *Barton v Barbour*, 104 U.S. 126, 26 L.Ed. 672 (1881).

of a *Barton* violation. "If the movant has a 100% probability of success on the merits," the injunction should issue "without regard to the balance of the hardships." *Sammartano v. First Judicial Dist. Court*, 303 F.3d 959, 965 (9th Cir.2002) (citation and internal quotation marks omitted). However, there is no general rule prohibiting suits against non-debtors. *See Chugach Forest Prods.*, 23 F.3d at 246-47. To obtain equitable relief, the party seeking the stay should be required to satisfy the usual preliminary injunction standard.

The parties also dispute what a bankruptcy court should consider with regard to the "likelihood of success" prong of the preliminary injunction standard. Appellants contend that Excel must show likelihood of success on its complaint in the adversary proceeding, specifically its claim that the arbitration violated the automatic stay under § 362(a). Excel rejoins that it needed to show only likelihood of success in reorganization.

We hold that a debtor seeking to stay an action against a non-debtor must show a reasonable likelihood of a successful reorganization. "The inquiry for a preliminary injunction necessarily focuses on the outcome of a later proceeding, at which time the merits of the questions giving rise to the litigation will be decided." *Commonwealth Oil*, 805 F.2d at 1189. Within the confines of the instant adversary proceeding, however, there is no "later proceeding" at which time Excel's claims will reach final disposition. Excel has already received the maximum injunctive relief—a stay until confirmation of a reorganization plan—that the

bankruptcy court could grant. *See Am. Hardwoods, Inc. v. Deutsche Credit Corp.* (*In re Am. Hardwoods, Inc.*), 885 F.2d 621, 624-27 (9th Cir.1989) (bankruptcy courts lack the power to issue injunctions that outlast plan confirmation). In this context, the most relevant "future proceeding" is the debtor's reorganization. Because Excel's claim is ultimately that arbitration would harm its ability to reorganize, it makes sense to require a showing of a "reasonable likelihood of a successful reorganization." *Homestead Holdings, Inc. v. Broome & Wellington* (*In re PTI Holding Corp.*), 346 B.R. 820, 826 (Bankr.D.Nev.2006) (considering likelihood of success in reorganization under merits prong of preliminary injunction inquiry); *see also Eagle-Picher Indus.*, 963 F.2d at 859-60 (same); *In re Monroe Well Serv., Inc.* 67 B.R. 746, 751-52 (Bankr.E.D.Pa.1986) (same); *Otero Mills, Inc. v. Sec. Bank & Trust* (*In re Otero Mills, Inc.*), 21 B.R. 777, 779 (Bankr.D.N.M.1982) (same); *but see FTC v. First Alliance Mortgage Co.* (*In re First Alliance Mortgage Co.*), 264 B.R. 634, 653 (C.D.Cal.2001) (collecting conflicting cases). Moreover, because the gravamen of Excel's adversary complaint is that the arbitration would harm the bankruptcy estate, adopting Appellants' approach would collapse the traditionally distinct merits and hardship prongs into a single hardship inquiry.

In sum, our usual preliminary injunction standard applies to applications to stay actions against non-debtors under § 105(a). In granting or denying such an injunction, a bankruptcy court must consider whether

the debtor has a reasonable likelihood of a successful reorganization, the relative hardship of the parties, and any public interest concerns if relevant.

B. *Proceedings Below*

Both the bankruptcy court and the BAP applied incorrect legal standards. Citing *Am. Hardwoods*, 885 F.2d at 623, the bankruptcy court stated that a preliminary injunction is proper whenever an action in another forum "could conceivably have any effect on the administration of the bankruptcy estate." That is actually the standard for determining whether the bankruptcy court has *subject matter jurisdiction* over a motion for a preliminary injunction. *Id.* at 623. Whether the bankruptcy court has subject matter jurisdiction is a distinct question from whether an injunction should issue. The two inquiries cannot be identical; otherwise a bankruptcy court would be required to grant every preliminary injunction motion over which it has jurisdiction.

The BAP likewise applied an incorrect standard. The BAP relied on the "unusual circumstances" doctrine the Fourth Circuit developed in *Piccinin*, which provides an exception to the general rule that the automatic stay does not apply to actions against non-debtors. *Piccinin* held that the automatic stay may be extended if unusual circumstances make the interests of the debtor and the non-debtor defendant inextricably interwoven. 788 F.2d at 998-1004 (affirming stay of actions against debtor's officers under a combination of § 362(a), § 105(a), and

the court's inherent equitable powers); *see also S.I. Acquisition, Inc. v. Eastway Delivery Serv., Inc.* (*In re S.I. Acquisition, Inc.*), 817 F.2d 1142, 1147-50 (5th Cir.1987) (extending the § 362(a) automatic stay to action against debtor's alleged alter egos). The BAP treated the "unusual circumstances" doctrine and the usual preliminary injunction standard as separate and distinct bases for affirming the stay. That is error, because the "unusual circumstances" doctrine does not negate the traditional preliminary injunction standard. As we have noted, stays under the doctrine, "although referred to as extensions of the automatic stay, were in fact injunctions issued by the bankruptcy court after hearing and the establishment of unusual need to take this action to protect the administration of the bankruptcy estate." *Chugach Forest Prods.*, 23 F.3d at 247 n. 6 (quoting *Patton v. Bearden*, 8 F.3d 343, 349 (6th Cir.1993)). Indeed, *Piccinin* itself applied the usual preliminary injunction standard in affirming the stay. 788 F.2d at 1008.

The bankruptcy court and the BAP alternatively found preliminary injunctive relief warranted under the usual preliminary injunction standard. We find that the injunction cannot be affirmed under their application of the usual standard.

As discussed above, the first prong of the usual preliminary injunction standard is whether the debtor can demonstrate a reasonable likelihood of success on the merits. The bankruptcy court did not consider that issue at all. That failure to consider a critical element of the injunction standard is reversible error. The BAP did

find that Excel had shown reasonable likelihood of a successful reorganization, but the BAP's finding is not supported by the record. The BAP noted that "Hoffman was actively marketing Excel's products in his consulting position." That mere fact is insufficient to show that Excel had a reasonable chance of successfully reorganizing. There is no indication in the record of what Hoffman's marketing activities are or how they could meaningfully contribute to Excel's reorganization. Excel's bankruptcy petition shows that it had no income from business operations during the past twenty-four months. Although it is not a high burden to show a reasonable likelihood of success in reorganization, the BAP's conclusion that Excel had done so amounted to an abuse of discretion because "the record contains no evidence on which [the BAP] rationally could have based that decision." *Benedor Corp. v. Conejo Enters., Inc.* (*In re Conejo Enters., Inc.*), 96 F.3d 346, 351 (9th Cir.1996).

The next prong is the balance of hardship between the parties. A bankruptcy court must "identify the harms which a preliminary injunction might cause to defendants and ... weigh these against plaintiff's threatened injury." *Caribbean Marine Servs. Co. v. Baldrige*, 844 F.2d 668, 676 (9th Cir.1988) (citation omitted). The bankruptcy court and the BAP ignored the potential harm to Indivos. The bankruptcy court stated without explanation that the "limited delay in the process of the arbitration will not result in appreciable harm to Indivos [and] Solidus." However, Indivos had argued that it would suffer harm from losing its bargained-for right to bring an arbitration

claim against Hoffman at a time of its choosing. *Accord PTI Holding*, 346 B.R. at 831 (weighing stay's adverse effect on bargained-for contractual rights). The bankruptcy court's "failure to identify, evaluate, and weigh the potential harm alleged by [Indivos] is reversible error." *Caribbean Marine Servs.*, 844 F.2d at 677.

The bankruptcy court did consider the potential harm to Excel, and found that (1) Hoffman might raise a defense of indemnification by arguing to the arbitrator that he acted as Excel's agent with a promise of indemnification from Excel; (2) denying the stay might lead to inconsistent results between the arbitration and the bankruptcy court; and (3) Hoffman might disclose privileged attorney-client communications, where Excel is the holder of the privilege, and Excel may have to participate in the arbitration to protect its privilege. These findings are insufficient to support the conclusion that Excel stands to suffer irreparable harm if arbitration proceeds.

We do not see how Excel would be irreparably harmed if Hoffman argues to the arbitrator that he breached the contract as an agent of Excel. An agent is always liable for breaching an independent obligation that the agent owes to the injured party, in spite of the fact that the agent may have acted in accordance with a principal's instructions. *See* 3 B.E. Witkin, *Summary of California Law* §§ 197, 199 (10th ed.2005). Indivos accuses Hoffman of violating a contract Hoffman signed. If that is proven, Hoffman is liable to Indivos whether

or not he acted as Excel's agent. The bankruptcy court stated that agency arguments would create "enormous problems" for Excel. Aside from possible disclosure of privileged communications, which is discussed separately below, the bankruptcy court did not explain what those problems would be. Speculative injury cannot be the basis for a finding of irreparable harm. *Goldie's Bookstore, Inc. v. Superior Court*, 739 F.2d 466, 472 (9th Cir.1984). In any event, even if Hoffman presents evidence that reflects badly on Excel, arbitration proceedings between Hoffman and Indivos cannot impose new liabilities on Excel for the simple reason that Excel is not a party to the arbitration.

The bankruptcy court and the BAP again engaged in speculation when they cited the risk of inconsistent judgments as justification for the injunction. The BAP explained:

> For example, the arbitrator might rule that Hoffman was acting as Excel's agent when he breached the settlement and the bankruptcy court might rule that he was not. Such inconsistent results could complicate Excel's litigation with Appellants, as well as any claim proceedings in respect to Hoffman's proof of claim for indemnification. Such complications would tax judicial resources.

The BAP's reasoning is unpersuasive. Although Hoffman repeatedly asserted his intention to defend the arbitration by claiming that he acted as Excel's agent,

the issue is simply irrelevant to the arbitration. Hoffman is a party to the Settlement Contracts. If he breached the contract, he is liable to Indivos whether he acted as an Excel officer or in his own interest. The bankruptcy court expressed concern that the arbitrator might disagree with that proposition, but the bankruptcy court identified no plausible legal theory that might support such a disagreement.

The only way that Hoffman's agency status might harm Excel is if Hoffman has a right to indemnity from Excel and the arbitration creates liabilities that Hoffman can pass on to Excel. Other courts have stayed suits against a debtor's officers where "unusual circumstances" made the interests of the debtor and its officers inextricably intertwined. *See, e.g.*, *Piccinin*, 788 F.2d at 1007; *Eagle-Picher Indus.*, 963 F.2d at 860. "In the Ninth Circuit, the vitality of the 'unusual circumstances' exception is not clear." *Chugach Forest Prods.*, 23 F.3d at 247. We need not determine the vitality of that doctrine today, because the bankruptcy court's findings do not support the conclusion that "there is such identity between the debtor and [Hoffman] that the debtor may be said to be the real party defendant and that a judgment against [Hoffman] will in effect be a judgment or finding against the debtor." *Piccinin*, 788 F.2d at 999. The bankruptcy court made no findings on whether Hoffman has an indemnity agreement with Excel, or whether that agreement actually covers Hoffman's potential liabilities from arbitration. The bankruptcy court merely noted that Hoffman might state a "defense" of indemnification; the statement sheds little

light on the scope and magnitude of Excel's actual exposure to Hoffman. Notably, unlike *Piccinin* and *Eagle-Picher Indus.*, there is no evidence that Excel has an insurance policy or other assets that would be immediately dissipated to cover a duty to defend and indemnify Hoffman.

The bankruptcy court also found that Excel will be harmed if Hoffman, to defend the arbitration, divulges privileged communication between him and Excel's counsel.[5] The only relevant evidence we have is Hoffman's statement that he will reveal privileged communication. Such conclusory allegations are insufficient to establish irreparable harm. *See Caribbean Marine Servs.*, 844 F.2d at 674-75. Ordinarily, the party asserting attorney-client privilege has the burden of establishing all of the elements of the privilege. *United States v. Munoz*, 233 F.3d 1117, 1128 (9th Cir.2000); *see also Admiral Ins. Co. v. U.S. Dist. Court*, 881 F.2d 1486, 1492 (9th Cir.1989) (setting forth elements of privilege). There is no evidence in the record to show that the communication Hoffman threatens to reveal is in fact, or at least likely to be, protected by attorney-client privilege. Moreover, it is unclear how revelation of privileged communication would harm Excel in a way

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5. The BAP noted that "the question of who has the privilege, Excel, Hoffman, or both jointly, has never been determined," and found it unnecessary to address that question. The issue should not have been ignored. Excel's rights could be harmed only if Hoffman discloses information to which Excel holds the privilege. If Hoffman alone holds the privilege, he has the choice to assert or waive the privilege.

cognizable under the Bankruptcy Code. *See Am. Hardwoods*, 885 F.2d at 625 (injunction must be consistent with the Code's objectives). Section 105(a) is not a general remedy to prevent the introduction of inadmissible evidence in proceedings in which the debtor may take an interest. The record is silent on how disclosure of privileged communication will in and of itself hamper Excel's ability to reorganize, undermine the rights of Excel's creditors, or otherwise undermine the objectives of the Bankruptcy Code.

Excel argues that it will suffer harm in the form of litigation expenses it will incur if it chooses to participate in the arbitration to protect privileged communication. However, since the arbitration is not against Excel itself and is not subject to the automatic stay, Excel's choice to expend money to participate in the arbitration is not by itself sufficient to establish irreparable harm. Excel must show that the expenses will be substantial enough to interfere with its reorganization or harm creditors. *See EEOC v. Rath Packing Co.*, 787 F.2d 318, 325 (8th Cir.1986) (litigation expenses insufficient to justify discretionary stay of a regulatory action that is not subject to the automatic stay); *First Alliance Mortgage*, 264 B.R. at 656 ("First Alliance presented no evidence other than conclusory declarations of counsel as to what the litigation costs would be if the multiple actions proceed separately."); *In re Gercke*, 122 B.R. 621, 627-28 (Bankr.D.D.C.1991) (declining to enjoin state court document production order where debtor has not shown that the expenses "will be substantial enough to threaten the administrators' other current administrative

tasks."). There is no evidence in the record on what the impact on Excel would be if it chooses to participate in the arbitration.

Although the bankruptcy court recited the usual preliminary injunction standard, the court failed to apply it. The court ignored both Excel's likelihood of success and the alleged harm to Indivos. Perhaps because the bankruptcy court initially granted the injunction under the mistaken view that any proceeding with any conceivable effect on the debtor should be enjoined, the court placed a much lower burden on Excel than what is ordinarily required to show irreparable harm. That is an abuse of discretion, particularly since Excel's weak showing on the likelihood of a successful reorganization heightened its burden to show irreparable harm. *See Caribbean Marine Serv.*, 844 F.2d at 674 ("A plaintiff must do more than merely allege imminent harm sufficient to establish standing; a plaintiff must *demonstrate* immediate threatened injury as a prerequisite to preliminary injunctive relief."); *see also Earth Island Inst. v. U.S. Forest Serv.*, 351 F.3d 1291, 1298 (9th Cir.2003) (holding that the district court applied an improper legal standard by imposing a higher burden of proof for irreparable harm than warranted).

Appendix A

V. CONCLUSION

We hold that a bankruptcy court asked to enjoin a proceeding between two non-debtors must balance the debtor's likelihood of successfully reorganizing with the relative hardship of the parties. Because the bankruptcy court abused its discretion by applying erroneous legal standards, we vacate the preliminary injunction and remand for further proceedings.

REVERSED AND REMANDED

APPENDIX B — ORDER FOR PRELIMINARY INJUNCTION OF LIMITED DURATION OF THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA DATED DECEMBER 9, 2005

UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA

Case No. 04-53874-ASW

CHAPTER 11

Adv. No. 05-5361

In re:

EXCEL INNOVATIONS, INC.,

Debtor.

EXCEL INNOVATIONS, INC.,

Plaintiff,

v.

AMERICAN ARBITRATION ASSN., METHVEN & ASSOCIATES, INDIVOS CORPORATION, SOLIDUS NETWORKS, INC., NED HOFFMAN, and DOES 1 THROUGH 20, inclusive,

Defendants.

Appendix B

ORDER FOR PRELIMINARY INJUNCTION OF LIMITED DURATION

Plaintiff EXCEL INNOVATIONS, INC., having previously filed an Application for Temporary Restraining Order and Injunction herein which came on for further hearing before the above-entitled Court on December 2, 2005; with Scott L. Goodsell of Campeau Goodsell Smith appearing on behalf of Plaintiff, and Randy Michelson of Bingham McCutchen appearing on behalf of Defendants INDIVOS CORPORATION and SOLIDUS NETWORKS, and John T. Hansen of Nossaman Guthner Knox & Elliott appearing on behalf of Defendant NED HOFFMAN; the Court having considered the pleadings filed, arguments made and evidence offered; for those reasons set forth in the record, which shall constitute the Court's findings of fact and conclusions of law, and good cause appearing:

IT IS HEREBY ORDERED that Defendants, and each of them, their agents, employees, officers, attorneys, representatives, and any other persons acting in concert with them, and each of them, are hereby ENJOINED from doing or causing to be done, directly or indirectly, by any means, any acts to re-commence or proceed with, prosecute or defend, in any way, that certain pre-Petition arbitration denominated *Indivos v. Hoffman et al.*, AAA No. 74-199-00671-03-LOPE ("Arbitration") pending either (a) confirmation of debtor's plan of reorganization or (b) further order of this Court based upon new circumstances presented,

including but not limited to confirmation of a plan by someone other than Debtor.

IT IS FURTHER ORDERED that INDIVOS' objections to and motion to strike portions of the supplemental Hoffman Memorandum and Hansen Declaration are denied.

IT IS FURTHER ORDERED that INDIVOS' request for sanctions against HOFFMAN and his counsel is denied.

APPENDIX C — EXCERPTS OF HEARING ON PLAINTIFF'S SUPPLEMENTAL APPLICATION FOR TRO AND PRELIMINARY INJUNCTION DATED DECEMBER 2, 2005

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

BEFORE THE HONORABLE
ARTHUR S. WEISSBRODT, JUDGE

In Re:

EXCEL INNOVATIONS, INC.,

Debtor.

EXCEL INNOVATIONS,

Plaintiff,

v.

AMERICAN ARBITRATION ASSN, et al.,

Defendants.

HEARING ON PLAINTIFF'S SUPPLEMENTAL APPLICATION FOR TRO AND PRELIMINARY INJUNCTION

Appendix C

[commencing at page 2]

THE COURT: Excel.

MS. MICHELSON: Good afternoon, Your Honor. Randy Michelson of Bingham McCutchen appearing on behalf of Indivos and Solidus.

THE COURT: Good afternoon. You've been here all afternoon.

MR. GOODSELL: Your Honor, Scott Goodsell for the debtor Excel.

THE COURT: Good afternoon.

MR. HANSEN: Good afternoon, Your Honor. John Hansen on behalf of Ned Hoffman, the defendant.

THE COURT: Good afternoon.

Does anybody want to say anything not in the papers?

MS. MICHELSON: No, Your Honor.

MR. GOODSELL: No, Your Honor. Submitted.

MR. HANSEN: Nothing, Your Honor.

THE COURT: Okay. With respect to the motion to strike, the motion to deny, some of the matters of which the motion is directed are simply argument and are not subject to a motion to strike. The remaining aspects of the motion are directed at matters which have been cured, by and large, by the Declaration of Ned Hoffman filed in response to the motion to strike, so the motion is denied.

[3] With respect to the injunction. The debtor seeks an injunction prohibiting Indivos; Solidus; collectively Indivos and Hoffman, former officer and director of the debtor-in-possession and current consultant to the debtor-in-possession, from taking further action in the pending AAA arbitration which will in any way affect the debtor's rights and remedies with respect to the matter subject to the arbitration.

The Court notes that one of the findings made in the arbitration is that Excel is liable for certain acts as Hoffman's alter ego. In the absence of an injunction the debtor asserts that it will suffer irreparable harm because the defendants will obtain evidentiary findings or legal conclusions which may well preclude the debtor from asserting its rights.

The debtor's arguments are based *inter alia* on the following. One, if arbitration goes forward, Hoffman's defense will be that everything he did was as an agent, an officer or a director of Excel and therefore Excel must indemnify him. Hoffman's testimony will involve disclosure of attorney-client privilege matters, and there's no way to protect that privilege.

Appendix C

I note that Indivos argues that Hoffman won't be able to make such a defense, but I'm not the person who's going to rule on that — those issue. It's going to be the arbitrator, and so I have to assume that there's at least a good possibility and maybe a probability that he will be allowed to make those arguments. But, in any event, I certainly don't have any [4] guaranty that he won't be able to make those arguments.

Second, the debtor's new management may not share Hoffman's defense position, which may create issues of inconsistent results.

Third, the debtor will be put in a position of having to pay twice for dealing with the same issues that the debtor must later indemnify Hoffman, as Hoffman argues, and then must litigate with Indivos on an objection to Indivos' claim in the bankruptcy case.

Bankruptcy Code Section 105(a) permits the Court wide latitude in fashioning orders to carry out the provisions of Title 11. The Court is cognizant of the fact that only under certain circumstances, narrow circumstances, does it have jurisdiction to enjoin a dispute between two nondebtor parties under Bankruptcy Code Section 105. 105(a) provides that the Court may issue any order necessary or appropriate to carry out the provisions of this title.

An injunction under 105 staying the litigation of a dispute between two nondebtor parties is appropriate when allowing the action to proceed, could conceivably

have any effect on the administration of the bankruptcy estate. *In re American Hardwoods, Inc.*, 885 F.2d 621 Ninth Circuit 1989; *In re Feitz*, 852 F.2d 455 Ninth Circuit 1988.

The Court finds on the record before it today that this standard is met. Because Hoffman's defense in the [5] arbitration will necessarily impact the debtor and there is a reasonable probability that it will negatively impact the debtor, the debtor has raised serious questions regarding the impact the arbitration may have on its estate if the arbitration is allowed to proceed at this time.

Accordingly, under Section 105(a), this Court will issue an order prohibiting the parties from proceeding with the arbitration. The debtor has shown that the continued arbitration with the proposed additional days of testimony will have an effect on the debtor and its estate and that effect is very possibly, maybe even likely to be negative.

The Court notes that Indivos believes that Hoffman will not be able to present this defense on the arbitration that shifts the blame to Excel, but the Court cannot speculate on whether this is permissible or not in the arbitration. This is obviously a decision for the arbitrator to make.

In order to protect the debtor the Court will prevent the arbitration from proceeding until the debtor's plan has been confirmed. The Court sees no other practical

way to serve the interests of all parties. Outside the context of Section 105 in the Ninth Circuit to obtain a preliminary objection, the moving party must show either a combination of probable success on the merits and the possibility of irreparable injury or, two, if serious questions are raised and the balance of hardships tips sharply in its favor.

[6] These are not different tests but two points on a sliding scale in which the degree of irreparable harm increases as the probability of success on the merits decreases. *Dr. Seuss versus Penguin Books,* 109 F.3d 1394 at 1396 Ninth Circuit 1997.

In other words, the greater the relative hardship to the party seeking the injunction, the less probability of success must be shown. *Clear Channel Outdoor versus City of Los Angeles*, 340 F.3d 810 Ninth Circuit 2003.

Any injunction issued in this matter is to protect the debtor and its estate. It is certainly not to protect Mr. Hoffman whose interests are of no concern to the Court. In order to protect the debtor the Court will issue an injunction which prohibits the parties from continuing with the pending arbitration until the debtor has confirmed its plan.

The Court will not prohibit, has no intention of prohibiting the parties from proceeding after that event pursuant to the *American Hardwoods* decision.

Appendix C

Using the rationale of the Ninth Circuit articulated in *Clear Channel,* the Court finds that on balance a consideration of the relative hardships between Indivos, Solidus, and the debtor favors granting an injunction for this limited period of time.

This limited delay in the process of the arbitration will not result in appreciable harm to Indivos, Solidus. On the [7] other hand, it will protect the debtor's estate and all of the creditors in significant ways that this Court believes are appropriate to allow the debtor to focus on its reorganization.

The Court has not considered any impact on Mr. Hoffman personally of going forward or delaying.

Any injunction will be for a limited period of time only and will not continue past confirmation of the debtor's plan. If Indivos, Solidus believes some earlier milestone event in this case or the related litigation between the parties pending in this court or the district court changes these considerations, if there are new facts that the Court needs to consider, it may seek to have the issue revisited in advance of confirmation of the plan.

Now the Court finds that this defense that Hoffman intends to raise, that everything he did was an agent, an officer or a director of Excel and therefore Excel must indemnify him creates enormous problems for the debtor and if the arbitration were allowed to proceed, including but not limited to disclosure of attorney-client privilege matters, it means that the debtor's lawyers would likely

have to be involved in the arbitration even though the debtor isn't a party to the arbitration and they have no control over Mr. Hoffman. It's — nobody else can assert these privileges for the debtor's estate with any reasonable basis.

At one point it was suggested that the arbitrator [8] could do that, but that doesn't make any sense to this Court. The arbitrator isn't a party. The arbitrator is a judge or an arbitrator, I guess by definition, and is certainly not in a position to assert whatever privileges the debtor would assert on its own behalf. And, as I say, the debtor doesn't control Hoffman.

It is true that the debtor's new management may not share Hoffman's defense position, and that can create inconsistent results. So the debtor is right about that. And the debtor may well be in a position of having to pay twice for dealing with the same issues for the reasons that the debtor has articulated.

So these are not frivolous points made by the debtor. The Court has considered this with a great deal of seriousness, and the debtor should submit an order granting the injunction.

With respect to the ruling of sanctions against Hoffman and his counsel, the request is denied. Sanctions were sought against Mr. Hoffman and his counsel on the theory that both had misled the Court and violated this Court's July 26 TRO ruling. There is

no basis to grant sanctions against Hoffman and/or his client on this record.

The Court does not find that there have been reckless misstatements of law and fact coupled with an improper purpose. The Court does not find that either Hoffman or his counsel has attempted to defraud it or mislead it. *Fink versus Gomez,* 239 [9] F.3d 989 Ninth Circuit 2001. Nor does the Court see a basis to conclude that there's been a violation of the July 26 TRO ruling.

It's not clear to this Court that anyone is acting in bad faith. Hoffman's counsel in this matter was not his counsel in the arbitration. His involvement is fairly limited — fairly recent and is limited, according to counsel's declaration, to bankruptcy matters. Accordingly, the Court finds no basis to award sanctions.

Thank you very much.

MR. GOODSELL: Thank you, Your Honor.

MS. MICHELSON: Thank you, Your Honor.

THE COURT: Do you want to say something that isn't in any of the papers in response?

MS. MICHELSON: No, Your Honor. I think we've said our —

THE COURT: So do I.

MS. MICHELSON: — we've laid out our view quite clearly multiple times and we respectfully disagree with the Court's conclusion.

THE COURT: And I understand that. And you're entitled to disagree and I respect that.

Thank you very much.

MS. MICHELSON: Thank you, Your Honor.

MR. GOODSELL: Thank you, Your Honor.

[10] MR. HANSEN: Thank you, Your Honor.

(Proceedings were concluded at 4:17 p.m.)

APPENDIX D — ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT DENYING PETITION FOR REHEARING EN BANC FILED OCTOBER 23, 2007

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

No. 06-17288

BAP No. NC-05-01510-MaSAl
Northern District of California,
San Jose

In re: EXCEL INNOVATIONS, INC.,

Debtor,

SOLIDUS NETWORKS, INC.;
INDIVOS CORPORATION,

Appellants,

v.

EXCEL INNOVATIONS, INC.; NED HOFFMAN,

Appellees.

ORDER

Before: GOODWIN, BYBEE, and M. SMITH, Circuit Judges.

Appendix D

Judges Bybee and Smith have voted to deny the petition for rehearing en banc, and Judge Goodwin recommended denial.

The full court has been advised of the petition for rehearing en bane and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing en banc is DENIED.